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Incentive pay programs in the construction industry.

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INCENTIVE PAY PROGRAMS IN THE CONSTRUCTION INDUSTRY

A Special Research Problem

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ABSTRACT

Incentive programs have become a hot topic in the last ten to twenty years. Many companies in various industries offer some type of incentive pay as part of their compensation package. The construction industry is no exception.

A literature search was conducted and a number of articles related to incentive pay were found. These were then used as a starting point from which to compare the construction industry.

General contractors, mostly in the Atlanta area, representative of the construction industry were surveyed to obtain a basis of comparison with industry in general. The results of this search and comparison are presented in this paper.

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INTRODUCTION

The CEO of Reebok International received a bonus of over $15 million after his company earned record profits in 1987. [Perry88] While a bonus of this magnitude is certainly the exception, bonuses, and on a broader scale incentive programs, have become a common part of business.

What effect does this concept have on the middle manager, or just as importantly the hourly employee? The status of any possible bonus or incentive pay are in fact part of a growing number of challenges being faced by today's managers. The key challenges, however, are the motivation and retention of workers and ultimately increasing company efficiency and profits. It is with these goals in mind that employers turn to investigate various possibilities -- the conclusions of their investigation -- incentive programs have some of the greatest potential for helping meet their goals.

As the United States shifts towards a more service oriented economy, the costs inherent to labor take up a much greater percentage of companies' expenses. As companies continue to search for ways to hold down their costs, remain competitive, and all the while increasing

efficiency and ultimately profits, incentive programs will receive more and more attention.

In many areas, Atlanta is on the cutting edge. Business, and in particular construction, is no exception. Atlanta's construction arena has become much more competitive since the boom of the 1970s. Whether or not the city and its surrounding areas will ever return to their previous frenzied pace, is not the question. Rather, during the leaner times, in both an effort to increase their profits as well as fiscally manage their on-going projects, many owners, managers and financiers searched out ways in which to increase efficiency within their ranks. Again, the solution reached by most, included the creation of a bonus and/or incentive plan of some type.

Whether business as a whole, or the construction industry as a specific is studied, when relating to sound business practices the area of incentives, bonuses and their proposed influence on profits need to be addressed. This is the purpose of this paper.

Initially, opinions of the "ideal plan" or at least points which should be addressed in the ideal plan will be reviewed, noting those commonly agreed upon. Then with

basics set forth, a comparison of the programs currently being used by Atlanta's general contractors will be made.

Construction, sales, service and a barrage of various industries have concluded that incentive packages are not unique concepts to be tried but perhaps have become starting point with which you entice the best or brightest to your firm.

BACKGROUND

Incentive programs can be as simple or as complicated as desired. Not inclusive, though exemplary of the various types, are the following:

* Performance Bonus
* Discretionary Bonus
* Gain Sharing
* Profit Sharing
* Commission
* Pay for Knowledge
* Perquisites
* Non-financial

Each of these will be discussed and its implications investigated throughout this paper. For the purpose of this function, it is imperative that working definitions be determined for each so that comparisons, as closely as possible, may be observed. Subsequently, the following definitions are offered, again for the sole purpose of comparison and contrast of incentive programs.

PERFORMANCE BONUS

A performance bonus is traditionally a lump sum payment made to an employee for performance, controlled in part or entirely by the employee, above some standards. The standards may range from those detailed in one´s employment contract to those based on purely subjective evaluation of the supervisor or employer. Performance bonuses are usually paid quarterly, semi-annually or annually.

The theory behind performance bonuses is that an incentive to go "above and beyond" will instill an increased motivation for employees to excel beyond their recognized job descriptions and expected duties. After all, they are paid to do their job to at least some minimum standards or risk being fired.

The obvious advantage to this plan is that an employer is only paying additional money for increased productivity. Whether there are standards based on a percentage above a stated goal, at which time it is objective, or through a subjective evaluation, the company would pay out a reward only in line with that which it is receiving.

One of the possible fallacies with performance bonuses, however, is the assumption that money is the primary motivator for employees. Additionally, there is the opportunity that through offering performance based bonuses one might be encouraging an atmosphere of quantity over quality, a dangerous position to be in, both financially and with regard to public perception.

DISCRETIONARY BONUS

Like a performance bonus, a discretionary bonus may either be offered as a possibility at employment, be one which develops based on the company's financial position, or additional services which an employee may offer to a firm.

Unlike the performance bonus, however, the discretionary bonus, as its name implies, is totally subjective in nature. Where it may be a subjective call by multiple people, it is not based on a set of standards or criteria from which all are compared. One of the simplest forms consists of a target or budget being provided to a supervisory level of management which then in turn decides how that money is divided among its employees. This

decision is not necessarily based on any type of personnel evaluation.

In this particular situation, employees are often left with more complaints about "the system" than with a reward which was intended to additionally motivate. There are a number of discretionary bonuses which can, however, offer great opportunities to companies to reward those who may offer new or efficient ideas to their employers.

For example, if a company employee, outside the realm of his or her job, develops a system which will save the company thousands of dollars, the company may offer to this person a discretionary bonus. This serves as a "thank you" gesture, as encouragement for others, and as a reminder that management takes care of people who take care of them.

Unfortunately, money is not always available in the budget to coincide with the desired timing of the award of a discretionary bonus. Subsequently, there can be quite a lag time between some type of deserved award and the actual cash payment. Additionally, some discretionary bonuses, such as a Christmas bonus, can quickly loose their intended effect as incentives. They may come to be expected and

rather than being received as a bonus, are perceived as additional salary.

The advantages of discretionary bonuses are that they require little management and are easily changed. This can offer to many companies an option to reward employees if they are financially able to do so.

GAIN SHARING

Gain sharing is closely related to performance bonuses. This type of incentive program is also traditionally paid out in one lump sum but is divided among a work group rather than paid to one individual. The performance criteria is typically more specific than for most performance bonuses and the work group has a direct influence on the results.

An example of this may be to look at the work of stone setting. While paid an hourly wage, a gain sharing program may reward both masons and their helpers based on each additional piece of granite facing put in place over a daily or a weekly quota. By making it a team concept, management is able to allow these smaller groups to both police themselves and act as their own encouragement team.

Still in all, gain sharing does take some management time, with checks of standards and notation of the overages and subsequent rewards. Additionally, one may have to take into consideration that all may be being rewarded while only a few members of the team actually did the work. As was discussed in the performance bonus, you also fall into the trap of encouraging speed over quality of work and perhaps in some instances even safety.

One of the common explanations for companies preferring a gain sharing program is that it rewards employees for their results regardless of company profits. This allows employees to be rewarded for their contributions even if there are other problems keeping the company from being profitable.

PROFIT SHARING

Perhaps one of the better known incentive programs is profit sharing. The concept behind this program is motivating employees to keep the company's interests in mind in whatever they do.

To encourage this, employees are made stockholders, either figuratively or actually, or partial owners of a company, receiving a portion of the company's profits when provided there are any. These monies are divided among eligible employees typically once a year after the company's financial reporting period.

The division of these profits is usually based on salary although other factors such as position and tenure many also come into play. Many companies utilize their profit sharing programs as a way of directly influencing employee longevity.

It is most common for these funds, when distributed, to be placed into retirement funds or in secured company stock. Whichever the case, neither the funds nor the stock may be cashed in or traded until after an employee leaves the firm after vestment or retirement. This in effect rewards someone for their "company man" attitude many years after the fact. Many question whether this incentive has any effect on behavior, as it is entirely based on each employee's perception of how much of an effect he has on company profitability.

COMMISSION PLANS

Mentioned here as a form of bonus or incentive, though not widely used in the area of construction, is the concept of commission payments. Usually used in a sales organization, commissions are traditionally based upon a set number of items sold and then either a percentage of the sales price is then paid to the salesperson, or based on the particular item, there is a set standard payment per item sold.

Commissions are, as mentioned, primarily used in a sales environment, and even more importantly where the salesperson has some control over the actual selling price of the item involved. It is in this narrower arena that the idea of a percentage payment comes into play. A common example, one thinks of real estate agents who can work within their market to capture the highest price of their item -- in this way they are rewarded for finding the optimum buyer by receiving a percentage of the final sales price.

Still in all, commissions are a favorite way of paying a minimum standard base salary, for it does offer the employer an opportunity to pay out only to those who are

performing for them. The base is usually so minimal that one would not accept it as their sole wages, but opt for it so they could be in control of their own paycheck, based on their performance.

From the above examples and definition, it is clear that this is not the most feasible of plans within construction, and one which has recorded little if any acceptance within the construction community.

PAY FOR KNOWLEDGE

Paying for knowledge, while not the espionage incentive it sounds like, is a very effective way for employers to encourage their laborers to acquire new and often specialized skills. With the work force remaining stable and the increase of opportunities facing potential employees, employers must learn both to attract new employees as well as provide opportunities for current employees to remain enthusiastic about their job and as up-to-date with regards to new technology as possible.

Basing a reward or incentive on these various needed skills is what paying for knowledge entails. Whether by encouraging upgrading status from helper to journeyman,

journeyman to master with some type of reward, or by rewarding the acquiring of new skills, creating better all around craftsmen and employees is the ultimate goal.

To better explain, it would be as if you were to reward an athlete for every sport he or she mastered. So many dollars for each event and then in return you have a well rounded athlete capable of competing and perhaps excelling in multiple areas.

As with the other programs, however, there are drawbacks. What of the employee who comes well schooled in a variety of areas. Is this unnecessary, for this employee, program one which he or she will view as unfair, offering incentives to co-workers in order to train them to their entering skill level? It is with this in mind that this program is rarely used by itself, but rather in combination with other programs. Additionally, it is often noted as available only at the lower entry levels, as an initial encouragement to employees recently hired, the group which also historically has the highest attrition rate.

PERQUISITES

Often when one is looking at a new job, they will wonder what perquisites go along with it. In this day and age, salaries and even monetary bonuses are not sole bases considered when looking at a new employer. Hence, welcome to the land of perquisites. Within this category there are a wide variety of types and new ones are being created daily.

COMPANY CAR: Providing a company car is perhaps one of the most commonly used by management in a variety of business situations. It allows companies to utilize both the financial advantage of depreciation of a company asset, all the while providing what has come to be a daily necessity to its employees. Company cars also allow one less financial check which a company must employ, ie: the checking of miles

Company Car
Insurance Plans
Education/Tuition Reimbursement
Matching Funds/Charitable Contributions
Vacation Time
Sick Leave
Relocation
Travel Rewards
Parking

driven and the calculations of reimbursement for that activity.

INSURANCE PLAN: Who today would not inquire as to the insurance plan of a potential employer? Whether basic health insurance, including both medical and dental, or including such things as long and short term disability, maternity/paternity leave, accidental death -- all have become an important part of our daily lives. Employers have quickly picked up on the need in the United States for insurance coverage, and rather than trust employees to maintaining coverage, they have produced company plans which based on company and or employment level you may pay partially into or receive as part of your benefit package. The savings for the majority of Americans is tremendous and subsequently, insurance plans have become a standard benefit offered by employers.

EDUCATION/TUITION REIMBURSEMENT: Similar in style to the pay for knowledge program detailed above, the benefit program takes education to its roots. If you, as an employee, wish to further your education -- some companies limit which areas are eligible, others allow any study at approved schools -- you may do so, and based upon your maintaining a specified grade point average, usually C+ or

above, the company will reimburse your tuition expenses. Some companies go one step further and actually will pick up all education expenses, including books and lab fees.

The return on this investment is multiple. First there is a proven sense of loyalty to those who have encouraged you, although many companies hedge their bets and offer reimbursement only after employees have worked off a repayment period during which the company feels they have received the return of their investment. Additionally, you encourage your work force to continually stay abreast with the latest developments in their field, complimenting their practical knowledge with that of scholarly insight.

This same program can be used in technical or vocational fields as well and it is here that quite often the employer receives the highest immediate return on their investment. Naturally, the quandary of whether you are investing in someone's education from which a competitor will ultimately benefit is one to be pondered, though as all benefit programs are created for the joint purposes of employer and employee, this seems to be a minimal consequence based upon the opportunities of benefit.

MATCHING FUNDS/CHARITABLE ORGANIZATIONS: While carried as both a benefit item as well as a standard marketing line item, the charitable contributions a company makes benefits employees in two ways. Initially, it is a community improvement item which is supposed to improve the environs in which the company's employees live. Secondly, the program may take on a matching funds program where employees may contribute to the charity of their own choosing and if it is one approved in the program, the company then will send matching funds to the same organization. This is especially effective with regards to supporting various educational institutions and larger philanthropies.

VACATION: When one recognizes that companies continue to pay employees for work which they cannot be completing due to their being on vacation, it is easy to see that this is in some ways a direct deficit to the company. In reality however, is it? The purpose behind vacation time is not solely for the benefit of the employee, it is rather an opportunity for employees to revitalize their enthusiasm for their job, have a mental break from the pressures of work and return with a fresh approach to work which may have been at a stand still stage for lack of insight.

In comparison to many other cultures, Americans vacation very little. This, however, does not take into account that with regards to these same cultures we may work shorter days or shorter work weeks. The interesting point, however, is that in the United States there is no social norm for vacation time. Where some employers offer one week for the first five years of employment, in other companies you could be to a level of three weeks vacation by that point, a definite difference to those vacation-minded individuals. The area of vacation is not one which is readily negotiated upon employment, that is with the exception of upper level management, it is simply accepted as a given.

SICK LEAVE: Along the lines of insurance, though often coupled with vacation plans, is the concept of sick leave. Noting that no person can be healthy 365 days a year for years on end, many companies build in a certain number of sick days during which an absence from the office is excused. After one reaches the set number of sick days, however, they are usually penalized vacation days or pay in order not to tax the employer unduly for their absences.

The combining of sick leave and vacation plans works as follows. As an incentive for employees to solely use

sick leave when they are actually ill, companies often reward employees who have not used sick days by exchanging them into vacation days, usually at a 2 for 1 ratio. Certainly one could in fact have more time out of the office by claiming illness, though through this program an employee can take "earned" time off at the encouragement of his or her employer.

RELOCATION ALLOWANCES: All good things must come to an end, at least perhaps in a specific location, and at that point, what options does the company offer? Should a parent company decide to move a manager to another part of the country, what does the relocation plan include? The basics include paying for the actual move itself, though in today's society that simply may not be enough. Whether current home purchase, the assumption of remaining mortgage, floating new housing pending the sales of the current home or financing a bridge loan, all are newly added conditions companies review with regards to relocation.

In the United States there is no longer strictly a one income family structure. In fact, in over twenty percent of households where both primary occupants work, women have the higher income. In contrast, however, it is

usually the man's job which relocates a family. Subsequently the addition of job search firms for the "other" family member has become more commonplace.

Rearranging relocation until the end of a school term and allowing a certain number of company paid tickets "back home" are but two of additional ways companies are beefing up their relocation programs.

TRAVEL REWARDS: Marketing for travel companies as well as hospitality related industries -- hotels, car rentals -- has taken a new turn, the idea of use incentives. Commonly known as frequent flyer programs, or frequent use programs, these rewards have become high ticket items. Where the rewards themselves are non-transferable, companies have begun to look at the possibility of utilizing points gained on company travel to be used towards future company travel, rather than to the individual's own personal benefit.

Where some may think this is a minimal company line item, imagine the current program developed by a couple of the nation's airline carriers where with only three trips you can "earn" a free ticket. Should the employee chose their own airline carrier, there is the initial fear that

perhaps higher priced airlines, hotel, car companies etc. will be utilized so that they may "earn" a reward, but aside from that let's investigate the bottom line. Say a businessman travels two weeks every month on some type of trip -- with this incentive program the company could cut their air traffic costs by 25%, basically reducing up to a quarter of their financial burden.

With the same program in line for hotels and car rentals, it is easy to see how this could strongly benefit the company, though historically has been left a "grey" item from which individuals have reaped the rewards. Now with credit card companies getting into the act, standards are being set. For dollars spent on company activities, including charges, airline tickets, hotels, and car rentals, many employers are insisting that some if not all rewards are then used on future company expenditures. This comes as quite a shock to many business people who have been financing their travel costs of annual vacations off of their loyalty accounts with various industries. Aware of the ethical implications, the United States Government has already come to the conclusion that no rewards will be used for individual gain, and companies such as IBM and other Fortune 500 firms seem to be following.

PARKING: While not as hotly contested as travel rewards, the idea of daily parking charges incurred by employees is one area which companies, primarily those located within a city, have had to recently investigate. Even in Atlanta parking charges in any of the downtown garages range from $55.00 to $95.00 per month. While not earth shattering compared to New York, this can amount to over $1,000.00 a year. This area is one which through bulk buying -- Atlanta employers are fortunate that there are still more parking garage spaces than cars and subsequently there is some room for negotiating -- the employers can provide a service at a cost less than the standard value.

NONFINANCIAL

Perception, or perceived value, is the tool of selling a benefit plan. Should there not be perceived value of an item or an offering, the employer need not to waste whatever resources, including the management of a program, on its inception. Perhaps one which is hardest to define, though often one of the most public types of incentive plans is termed here nonfinancial. These are the programs that public relations people love. They include programs such as the selection of an employee-of-the-month or

employee-of-the-year and the payment of the membership fees or annual dues of various professional organizations.

There are programs which offer rewards for safety in the form of additional days off and programs which offer discounted purchase prices on company produced items to employees and sometimes their families. An extension on this second concept is the traditional company store. The types of programs are as endless as is the employer´s imagination.

Quite often nonfinancial programs are ones which are designed to effect only a few, though are important as they offer opportunities of benefit to the employer which can also be perceived as a benefit to employees.

Benefits of any type, as stated, are only as effective as they are perceived to be. Regardless of the dollars spent or time invested in any program, if those who are to be benefiting do not see the reward worth the effort, then the program is doomed to fail.

Many companies include their employees, and at very least their management, in the creation of their incentive program. In this way they receive both input with regards

to importance and desired rewards, and just as importantly receive that all important support from the onset.

INDUSTRY AND "IDEAL" PROGRAMS

So the question then is how to develop an effective incentive program by using one or a combination of these various types of incentives. There are many challenges involved with choosing or changing an incentive program and the results can be almost immediate and possibly disastrous.

General Health, Inc. wanted its thirty plus employees to work toward increasing revenues. The CEO promised everyone in the company an extra month's pay if they reached the sales target. Sales began to shoot up as desired, but so did expenses - so much so, that the company started loosing money. "Incentive compensation, *in practice*, has a history. And history has its lessons." [Posner88]

A history yes, and incentive programs aren't new, but neither is there a "sure-fire" program that will work for every company. It takes a lot of thought and planning. The following are pieces of advice from some of those who have studied incentive programs.

Posner´s Laws are shown in Figure 1. First and foremost -- "don´t copy" someone else´s program. Which isn´t to say that similar programs won´t work, just that it can be very dangerous to copy another program without first analyzing it very carefully.

Second, provide checks and balances in the program. By setting individual or small unit goals such that the overall company desires are met without being at the expense of a secondary goal. A manufacturer set its target as increased productivity. With no secondary goals, they got just what they asked for -- increased productivity. Unfortunately it was at the cost of quality and they ended up doing a great deal of rework.

POSNER´S LAWS
Don´t copy.
Make the goals different for everybody.
Poke holes in your system.
Don´t walk away.
Follow the money.

Figure 1 [Posner88]

Third, analyze the plan and pick it apart -- play "devil´s advocate". A very general plan may spell trouble. As the example of General Health, Inc. demonstrates, not anticipating all the possible results can be dangerous.

Fourth, pay close attention to the way the program is perceived by employees. By accepting worker input and fine-tuning the plan, everyone will be better off.

And fifth, track where the bonuses are going. If the people being rewarded are not the ones that were expected, the plan may be in need of adjustment.

Taking a step further and discussing the "nut and bolts" of a plan are Daniel Rowland and Bob Greene. "Once the appropriate type of plan has been selected, work can begin on the six basic issues of plan design." as shown in Figure 2. [Rowland87]

SIX BASIC DESIGN ISSUES

1. Plan objectives.
2. Eligibility.
3. Performance criteria.
4. Award level.
5. Funding formula.
6. Method of payment.

Figure 2 [Rowland87]

The first design issue is identifying company objectives for an incentive plan. Often a company's objectives are to increase productivity or efficiency, to attract or retain employees, to control overhead, or to place more risk with the employee. Whether it is one or a combination of the above,

clearly defined objectives are the cornerstone of a properly designed incentive program.

Selecting the right people for inclusion in an incentive program can be crucial. Employees know which jobs are "important" and which ones aren´t. "The frequently used ´mechanical´ eligibility criteria (officer status, grade level, salary, and so on) are poor substitutes for a more reasoned selection process. .... In deciding whether an employee should be included in the plan, three questions should be raised:

- What is competitive practice relative to plan participation?

- What is the job´s impact on the unit results? If the job does not have a significant impact on the unit´s overall performance, including it in the plan uses available fund without significantly helping the unit meet its goals.

- How measurable is the position´s contribution?" [Rowland87]

If all employees are eligible for the same incentive pay, the program may not be perceived as being "fair" or particularly well thought-out.

The third design issue is determining performance criteria. "Whatever measure is used, three standards should be adhered to:

- The performance measure should relate directly to the unit's business objectives. Whatever the staff is being rewarded for doing should be part of the business plan.

- To the extent possible, the performance measure should be quantifiable in advance and therefore measurable. Often objectives that seem highly subjective on the surface can be made measurable with a little care.

Even if qualitative criteria are used, it is necessary to have a scale for management.

- The measure must be integrated with the goals of the larger organization. The plan should not direct the efforts of employees in the unit in one direction while the rest of the organization is going in another." [Rowland87]

The next design issue is to set the threshold performance level. While it might seem to make sense to use past company performance, the more information available about competitors or the market, the better with which to make an educated decision. An improperly conceived award level could result in overpaying

underachievers or underpaying the best workers in the company.

The fifth design issue is to develop a funding formula. Setting salaries low and rewarding performance with substantial bonuses is one tact. Or setting salaries high and paying out smaller bonuses in another rationale. There are a number of issues which come into play in this decision not least of which is can quality employees be attracted if the base salary is set too low?

The last design issue is the method and timing of payments. "Cash and/or stock are the basic ´how´ alternatives." [Rowland87] Note that investment in a retirement plan is not listed here. Most employees consider a retirement plan a benefit and perhaps an incentive to stay with a company but not as a motivator to perform.

The timing of payments can have a substantial impact both on the cash flow of the company and the tax burden of the employee. The deferral of payments is something that should be considered although "Behavioral theory argues the strength of the incentive is best reinforced if the payment

is made as soon as possible after the accomplishment." [Rowland87]

Also to be considered is whether or not to include bonuses in the calculation of benefits such as health insurance, etc. Typically benefits are not based on any type of variable pay including overtime.

Professor Marc J. Wallace, Jr. of the University of Kentucky does not differ with these "laws". He conducted a two-year study during which he interviewed 45 companies that had made drastic changes to their pay systems. In his MAKING INCENTIVES WORK and TESTS OF AN INCENTIVE PLAN, as shown in Figure 3, he provides his recommendations.

One of the more interesting results? "Of the six companies he studied that put in incentive programs for no clear reason, all six failed." Hence "Start with a clear strategy. Think hard about your goals. Focusing just on customer service, for example, could also raise costs." [Perry88]

Second, concentrate the plan on jobs which produce easily measured results.

MAKING INCENTIVES WORK

1. Start with a clear strategy.

2. Focus on jobs that can be measured.

3. Decentralize incentives.

4. Separate incentives from base pay.

5. Create a "sunset" provision.

TESTS OF AN INCENTIVE PLAN

1. Does the plan capture attention?

2. Do employees understand the plan?

3. Is the plan improving communications?

4. Does the plan pay out when it should?

5. Is the company or unit performing better?

Figure 3 [Perry88]

Third, provide managers the leeway to tailor the plan as they see fit.

Fourth, do not include bonuses in with regular pay checks. By providing separate checks, it gives a clear indication of the bonus amount and highlights the noted performance.

Fifth, include in the plan conditions under which either drastic changes or complete cancellation will need to occur. This provides a much more acceptable method for deciding to make changes to a program without causing employee discontentment.

And some questions to determine if an incentive plan is working. First, are employees taking notice of the

plan? Are they discussing how to achieve their goals? If not, this could be the sign of a lackluster plan.

Second, do those eligible under the plan understand how the program works? If the program is too complicated, the desired motivational effects may not be as great as desired.

Third, have employees learned more about their jobs and/or the company business plan? Again, if not, the plan may be in trouble.

Fourth, are employees being paid when the desired results have been achieved? If not, employees may lose interest or begin to view the program as unfair.

Fifth, is the company doing better because of the incentive program? After all, isn´t this the reason for having an incentive plan in the first place?

Are companies performing better? Where has industry gone with their knowledge? "The most widely used form of incentive compensation is profit sharing: More than 30% of U.S. companies have it. About 85% of these defer at least part of the bonuses by putting them into employee

retirement funds, but more and more are paying employees in cash. The immediate reward helps hold down salary and wage increases." [Perry88]

However, "For companies that are serious about using incentives to motivate workers, gain sharing is the best bet. It is most effective in plants or business units comprising 500 people or fewer, and rewards employees for results they can directly influence: for instance, producing more steel per hour or collecting on more delinquent accounts.

Although gain-sharing plans have been around for 50 years, they have lately become the fastest-growing form of incentives. Edward Lawler at the University of Southern California's Center for Effective Organizations says that 26% of U.S. companies use some form of gain sharing. About 75% of these plans have been adopted since 1980." [Perry88]

And even these strategies do not address the use of nonfinancial rewards. "There is a virtually unlimited range of nonfinancial rewards. They are limited only by your creativity and ability to afford them, but you can view them as falling into two general categories:

1. Tangible or 'extrinsic' rewards. These are prizes, commendations, or privileges that have demonstrative value

and convey status or recognition. Examples are plaques, jewelry, extra vacation time, or gift certificates.

2. Intangible or 'intrinsic' rewards. These are more personal -- privileges or opportunities to grow and contribute in more satisfying ways. They may include positive verbal feedback, greater authority, leadership recognition, increased involvement in decision making, training and development opportunities, or participation on internal task forces." [Burchman88]

"Perquisites represent a relatively small portion of the total executive pay package, but their power as a status symbol should not be underestimated." [Tharp87]

"Once you get it right - suitable goals, good ways to keep score - you can hope that the most difficult part is over. But don't count on it. The track record shows that the most difficult part may be when performance prevents the rewards from kicking in." [Posner88]

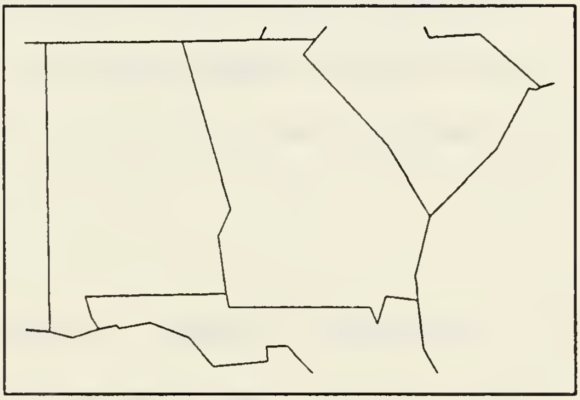
And how have companies put these various programs to work? Lincoln Electric has had 54 years without a losing quarter and 40 years with no layoffs. In addition, such giants as GM, Ford, Motorola, TRW, and McDonnell Douglas have sent visitors to Lincoln, the "holy shrine of

incentive pay", in order to observe first hand their renowned incentive pay program. [Perry88]

Nucor, a non-union steel-maker, has not had a losing quarter in 35 years and has not had any layoffs in twenty years. But more importantly, Nucor´s steel-workers produce more than twice as much steel as their union counterparts while averaging more earnings as well due to their incentive pay. [Perry88]

SURVEY RESULTS

A survey of over twenty of some of the larger general contractors in the Atlanta area was conducted to determine the types of incentive programs in use and the level of interest in this subject. Of the companies reporting any type of incentive plan, the vast majority have either recently modified their plan or are currently considering doing so.



These companies, though basically satisfied with their current plans, either have begun to perceive a "watering down" of their programs or are interested in maximizing the effect of their incentive dollars.

Currently by far the most popular type of incentive program among Atlanta general contractors is the performance bonus plan. Eighty-two percent of the companies surveyed have procedures in place to award some type of performance bonus. It is interesting to note that

nearly every company that does not have a performance bonus plan does not have any type of incentive program whatsoever.

Generally speaking, the types of performance bonus plans encountered can be divided into four categories. These categories are based on the personnel eligible for the program as the differences in the way the programs are administered are minimal.

The four categories are 1) company officers, 2) salaried employees, 3) all office personnel and any field personnel with extended service, and 4) all company employees.

Traditionally, these performance bonuses are paid after the end of each company's fiscal year. In so doing, the overall bonus budget may be calculated as a percentage of company profits. Although this may then seem to be some sort of profit sharing, it is more correctly described as a convenient way to arrive at a budget. A "pure" profit sharing program would divide the profits among those eligible based strictly on a funding formula but not based on performance.

Most companies either have a committee which makes decisions concerning who is to receive bonuses based on managers' recommendations or leave it entirely up to managers. A budget is usually provided by taking a percentage of before tax company profits.

The second most used type of incentive program is profit sharing - sixty-four percent of the companies surveyed have a profit sharing program. Generally, these plans also fall into the same four basic categories as the performance bonus plan although in almost all cases the range of personnel eligible for profit sharing increased over those eligible for performance bonuses. There are some companies, however, that have performance bonus plans and nothing else.

In all cases, the profit sharing budget is based on a percentage of company profits (usually in the range of ten to twenty percent) before taxes. Each person's share of that amount is obtained from a formula based on their individual salary compared to total salaries. In some cases, longevity or company position are also taken into account.

The amount of time for employees to become vested in the various profit sharing program ranged from none to seven years although one to three years is more common. With few exceptions, all money is placed into a retirement fund. This money is then unaccessible until such time as the employee leaves the company after vestment or the employee retires.

Three of the companies surveyed, however, make cash payments of up to half of the amount with the remainder being placed in a retirement fund. This does not preclude the option for the employee to place his own money in the retirement fund and in fact is an option of most every retirement fund.

Discretionary bonuses are used by only two of the companies surveyed although it could be argued that some performance bonuses are more subjective than objective and should therefore be classified as discretionary. Christmas bonuses are the most common type of discretionary bonus. There is one program of note that offers "token" cash payments as part of a broader employee recognition plan and will therefore be covered later.

Gain sharing is in use as an incentive program at four of the companies surveyed. The only programs of this type encountered are geared toward project management staff or more specifically project managers and superintendents and are based on specific project results.

One method for determining the amount of money to be paid in this type of program is based on the project labor budget. The project management staff shares in the savings of the labor budget by each member receiving a percentage of the savings, if any.

Another method is based on the expected profits of a project. The project management staff shares in any profits over a specified threshold.

One company also offers a supplemental type of gain sharing bonus which is based on the project schedule. The project manager and superintendent each receive a set amount for each week ahead of schedule that a project is completed.

Although not currently in use at any of the surveyed general contractors, another type of gain sharing program that has been tried by at least one company is based on

hourly employee productivity on a specific project. Disagreements arose over who in a given crew actually performed the work, how any money should be divided among the crews and what type of work should be eligible for the production pay. In addition, quality often suffered. Since general contractors may be involved in such a myriad of tasks, this type of program is perhaps best left to subcontractors that specialize in certain trades.

Perquisites run the full gamut - stock options, parking, education, professional dues and journals, vacation, health insurance, company car, travel expenses, matching funds, etc.

One company has a rather unique incentive plan designed to encourage safe work practices. For each 2000 hours of accident free work done by field hourly personnel, an award is paid based on a standard reward multiplied by the number of accident free periods. This can be thought of as gain sharing since, in effect, the employees are sharing in the reduced health insurance or medical payments that a company must make.

Another unique plan encountered was an extensive employee recognition program. Sometimes accompanied by

small "token" cash payments, this program includes monthly awards luncheons, plaques for significant contributions, and company sponsored parties.

And have general contractors fared well? Many of the companies surveyed have been established in the Atlanta area for over twenty years and some for well over fifty years. While longevity might not equate to consistent success in many types of businesses, with the construction industry being as it is, this is in fact a testimony to their success. It is not possible to claim, however, that incentive programs have necessarily made the difference between successful and unsuccessful companies as there are a number of well established construction companies that have no type of incentive program.

COMPARISON OF CONSTRUCTION PROGRAMS WITH "IDEALS"

So how, then, do construction industry incentive programs compare with the idealistic advice? But perhaps before answering that, the first issue that should be addressed is to compare construction with industry in general.

One of the first differences to come to mind is that the companies addressed in the reference articles are mostly targeting blue-collar workers for their incentive programs whereas construction companies are more often than not targeting those involved with project management such as superintendents, project managers and perhaps project engineers or even vice presidents.

The cash flows of construction companies can also be quite different from most industries. Cash flow, at least for a specific project, can be negative for extended periods until the end of a project when retainage and profit are paid. Therefore, incentive pay may be much more cyclical. "Some industries are on multiple year cycles, but very complex plans are necessary to accommodate this type of economic environment while retaining a reinforcement effect." [Rowland87]

Construction has a much different nature than say, manufacturing. Manufacturers can measure output in units produced in a relatively short period of time. Construction progress, on the other hand, is much more difficult to measure since each construction project is different and may last a number of years.

Additionally, construction firms often must be bonded and therefore are subject to close financial scrutiny by sureties. As such, they may feel it much more important to base any type of incentive pay on company profits thereby reducing the risk of having to pay bonuses during a bad period which would reflect poorly on their financial statements.

Keeping in mind Bruce Posner's first law, -- "don't copy" -- it is not necessarily wrong not to fall into line with the advice given earlier. In fact, it would more than likely be disastrous to do so. Nonetheless, it is important to note any differences and consider any reasoning behind those differences.

Of the performance bonus plans encountered, not all can be said to have clearly defined objectives nor

performance criteria. Basing a bonus on a performance evaluation is a fairly good method but places even more importance on the evaluation process. If the evaluation process is perceived as overly subjective, then so too will the bonus program.

However, the second part of the equation is the award level or type of performance which qualifies an employee for a bonus. It is in this area that most general contractors' performance bonus plans become subjective. In their defense, it is not an easy matter to provide detailed performance criteria and award levels in the construction business.

Performance bonus plans typically pay cash bonuses based on overall bonus budgets which are in turn based on company profits. Since these payments are made in cash separate from regular pay checks, the only noted room for improvement would be in the area of the bonus amounts. One possibility would be to set a minimum bonus for reaching the award criteria regardless of company profitability. " Berkshire Hathaway Chairman Warren Buffett, who calls himself 'the ultimate believer' in well-designed incentive compensation plans, believes they should (pay bonuses even if the company is not making profits). 'If I had the job

of running a football team that was last, but had two outstanding players, I wouldn't pay them less just because they had a lot of clods around them,' he says. 'Then we'd stay last. Basically, you've got to pay for talent in this world.'" [Perry88]

The personnel eligible for performance bonuses is the most distinguishing feature of the various plans discussed earlier. Obviously there is no right or wrong eligibility criteria; each company has its own compensation philosophy. If not already in place, however, perhaps bonus ceilings or guidelines for various types of job levels should be established.

Discretionary bonuses are, as their name implies, best left to the judgement of each company and its managers although there should be some type of rationale made available to employees so that this type of bonus is not considered completely unfair.

Profit sharing seems to be one of the more common types of incentive programs in both industry as a whole and construction. The underlying objectives, however, are not entirely clear. Some general contractors provide profit sharing plans strictly as retirement programs while others

pay out part of these monies in cash as a type of incentive or reward. "Corporations commonly adopt profit-sharing programs in the belief they will increase productivity. But they are not effective motivators, say most compensation experts, mainly because most employees have little influence on profits. Says Jerome M. Rosow, president of Work in America Institute, a nonprofit research firm: 'Many things that affect profits, such as pricing policy, the market environment, and taxes are unrelated to workers' performance. One financial decision, such as taking on a lot of debt or making an acquisition, can wipe out anything the workers can do.'" [Perry88]

Perhaps at least half of the profit sharing amount should be paid in cash. It is usually an option for employees to invest their own money in retirement funds on top of the amount paid in by the employer and most plans at least allow, if not require, that employees "cash in" their fund when they leave the company (after vestment, of course). What purpose is served by denying employees the choice of having access to their money once they have reached vestment? Is there some nuance in retirement plan requirements that has been overlooked?

Gain sharing is the probably the most specific of any of the incentive plans in use by general contractors. The plan objectives are clear -- come in under budget or ahead of schedule. The personnel eligible are usually limited to superintendents and project managers. The award level and funding formula for gain sharing programs are also well defined and the payments are made in cash separate from regular pay checks to provide the most amount of positive reinforcement.

The performance criteria may be the only area which could be changed for the better. Most of the gain sharing programs are based on a dollar amount budget and yet the cost of materials or even labor cannot be controlled by the project management staff. A material quantity or labor hour budget, however, is much more under their control. Unfortunately, a drawback to this type of criteria may be the additional effort required to track the necessary information.

Nonfinancial incentive plans are also not easily compared with "ideals". It is quite important, however, to keep close tabs on this type of program for "In a 1986 survey on nontraditional award systems, only 30 percent of the respondents who had such programs said they had a

positive impact -- 35 percent said their impact on employees was negative." The three main reasons for dissatisfaction were, "1. The criteria and objectives of the program are unclear. 2. Employees perceive the selection process as unfair. 3. Very few employees are eligible." [Burchman88]

CONCLUSION

"Money motivates, or at least it can. The challenge is getting it to motivate the right kinds of behavior, which is harder than it sounds." [Perry88] The 1990s are expected to bring a steady shift toward a more service oriented economy. And many companies will continue to explore incentive programs as one of the better ways of remaining competitive.

In many ways, incentive programs in the construction industry are not that different from those in industry as a whole. As part of an overlying compensation package, each company in each industry has made its choices as to just how involved the management cares to delve into incentives.

And though incentive plans are certainly not a "cure-all" for boosting productivity or efficiency, they are one of a number of tools that can provide dramatic results. And the key to any of these tools is proper management.

As general contractors review or consider establishing incentive plans, there are some good sources of background information available to management. But in the end, it is

up to the management of each company as to what will be done with this information.

Some directions for the future may include such changes as better defined incentive plan objectives, performance criteria and award performance level. Or the concept of profit sharing may be modified so that employees are at least given a choice in whether or not their rewards are invested for retirement.

Another possibility would be to see an increase in the use of gain sharing throughout the industry. And then perhaps performance criteria for gain sharing might be changed to something other than a dollar budget amount.

And maybe minimum bonuses will become common which would see employees rewarded for outstanding behavior even if the company is not doing as well. Sounds risky, but then construction is a risky business and this type of philosophy may be the one that attracts the very best personnel in the field.

In any event, incentive programs are a part of the construction industry and are likely to increase in use. And more than any other factor, it is employee perception

of these plans that is important. As companies continue to grow, it will become all the more important for them to have well designed and managed incentive plans to preclude a "watering down" effect. If employees lose interest in an incentive plan, it is certainly doomed.

But incentives are just one part of an overall company philosophy concerning the treatment of employees. Taking this one step further, both compensation and promotion policies can play an important role in employee motivation and retention. It is in these areas that future research is suggested and the article "The Link Between Compensation Design and Succession Planning" by Charles Glen Tharp is a good starting point.

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The Companies - all of which preferred to remain anonymous